SECTION II – SPECIFIC COMPLIANCE
FUND 30 – CAPITAL PROJECTS FUND

Bond and Note Authorizations

Bonds and notes authorized by the voters (Type II) or the Board of School Estimate (Type I) are reported at the face amount as "Other Financing Sources" in the capital projects fund in the year of issuance/sale (GASB 37, par. 16). Debt issuance costs paid out of proceeds should be reported as expenditures (GASB 34, par. 87). Bond debt is reported as a liability on the district-wide *Statement of Net Assets*

Bond Anticipation Notes

Funds received from the sale of bond anticipation notes (BANs) are not considered "Other Financing Sources" but are reported as a liability in the capital projects funds. Refer to Chapter 13 of the GAAP Technical Systems Manual for further guidance on BANs.

General Borrowing Authority

The following discussion of statutory authority for boards of education to borrow funds is not intended to be comprehensive, but to provide district personnel and auditors an overview of statutes and regulations relating to borrowing authority for districts. A district board of education should consult with the board solicitor for interpretation of the law given the particular district's circumstances. Also refer to the Local Bond Law (*N.J.S.A.* 40A:2-1 et seq.) for further guidance when approvals by the Local Finance Board are required. District boards of education do not have statutory authority to borrow in anticipation of EDA/SCC grants, nor to borrow from banks or other lending agencies to finance acquisitions beyond those areas listed below. Regional school districts should refer also to *N.J.S.A.* 18A:13-26 et seq.

N.J.S.A. 18A:20-4.2. Powers of boards concerning real property [Lease Purchase Agreements]

- (f) The board of education may acquire with approval of the commissioner, the voters or board of school estimate as applicable, improvements or additions to school buildings through lease purchase agreements not in excess of five years. A district may, without separate approval, also acquire equipment through a lease purchase agreement not in excess of five years, or in the case of an agreement entered into for the acquisition of school buses not in excess of 10 years, provided that the amount of each installment payment is included in the budget submitted to the voters or board of school estimate, as appropriate. Lease purchase agreement refers to any agreement which gives the board of education as lessee the option of purchasing the leased equipment or improvements or additions to existing school buildings during or upon termination of the lease, with credit toward the purchase price of all or part of rental payments which have been made by the board of education in accordance with the lease.

- (h) The board of education may acquire through sale and lease-back of textbooks and non-consumable instructional materials provided that the sale price and principal amount of the lease-back do not exceed the fair market value of the textbooks and instructional materials and that the interest rate applied in the lease-back is consistent with prevailing market rates or is less.

N.J.A.C. 6A:26-10.1 et seq. Lease Purchase Agreements

- Provides additional regulation on use, approval, contents of agreements of five years or less and of ground leases, procedures for refinance or defeasance of lease purchase agreements.

N.J.S.A. 18A:22-25 (Type I) or *N.J.S.A.*18A:22-44.1 (Type II). Borrowing against appropriation on notes

- The board of education may borrow after July 1 and before January 1 a sum not exceeding one half of the amount appropriated for the current expenses of the schools, repair and maintenance of a school facility (capital outlay) [Tax Anticipation Notes].

N.J.S.A. 18A:22-42. Borrowing upon notes in anticipation of taxes (Type II)

- Boards of education may borrow in anticipation of taxes to be raised, levied and collected for budgeted expenditures, the amount authorized, notes maturing not later than December 31 of the year in which such taxes shall be raised.

N.J.S.A. 18A:24-1 et seq. Loans, Bonds and Other Obligations

- Provides authorization in general for school district bonds and temporary notes and prescribes maturities, methods of payment, limitations, requirements of form and execution of bonds, sale and use of proceeds, and requirements when refunding.

N.J.S.A. 18A:24-2. Borrowing on tuition due from another district

- Districts may borrow an amount not exceeding 80% of the amount due for tuition from another school district.

N.J.S.A. 18A:24-3. Borrowing in anticipation of issuance of bonds [BANs]

- By board resolution, a district which has been authorized to issue bonds, may authorize the issuance of temporary notes or loan bonds as money is required for the projects for which the permanent bonds are authorized.

N.J.S.A. 18A:24-5. Purposes and maturities for which bonds may be issued

- Provides for the various maturities of bonds depending on the particular purpose with the maximum being 40 years.

N.J.S.A. 18A:24-61.1 et seq. Funding or refunding bonds at or prior to maturity

- Bonds issued by a district may be funded or refunded prior to maturity. Although there is no minimum period of time for the maturity schedule, N.J.S.A. 18A:24-61.8 establishes the maximum period of 40 years. The amount of refunding bonds is determined by the governing body of the municipality, county or board of education, as applicable, and must be approved by the Local Finance Board. The Local Finance Board in virtually all cases requires that the final maturity date of any refunding bond issue not exceed the final maturity date of the bonds being refunded.

N.J.S.A. 18A:24-61.2, as amended by Chapter 42, P.L 2002, effective July 12, 2002. Refunding bond exclusions from net school debt

- Refunding bonds may be authorized and issued for the purpose of refunding the cost of retiring the present value of the unfunded accrued liability due and owing for early retirement incentive benefits granted by the board of education pursuant to P.L.1991, c.231 and P.L.1993, c.163.

- The cost or expense of issuing refunding bonds including printing, advertising, accounting, and financial, legal or other expense in connection therewith may be added to the issue.

- The issuance must be preceded by a "refunding bond ordinance" adopted by the board of education of the school district.

N.J.S.A. 18A:20-4.2, as amended by P.L. 2000, c.72 (*N.J.S.A.* 18A:7G-1 et al.) Acquisition, improvement, lease, etc. of property for school purposes; authority of board of education

- Financing a capital project may be by issuance of certificates of participation for a lease purchase agreement greater than five years only if approved by the Commissioner of Education and the Local Finance Board in the Divisions of Community Affairs prior to EFCFA (July 18, 2000).

Bond Sales and Capital Projects Fund Activities

All proceeds related to the sale of bonds are recorded in the capital projects fund. The board cannot use a premium in excess of the bond authorization or the accrued interest for capital purposes since the board is limited by the amount voted or certified. Receipts from premiums in excess of the authorization are transferred to the general fund or debt service fund. Receipts from accrued interest are transferred to the debt service fund.

Because of statutory limitations, interest earned on the investment of unexpended cash balances in the capital projects fund must be transferred by board of education resolution to either the debt service fund or the general fund at the discretion of the board of education. Interest earned cannot be used for the referendum project(s) unless expressly authorized, with the amount, in the referendum. Any amounts not transferred at June 30th must be recorded as an interfund receivable/payable. Other important issues related to the general fiscal administration of the capital projects fund are discussed in Policy Bulletin 200-13 dated October 1996. Guidance is also found in *N.J.A.C.* 6A:26-4 and the October 2001 guidance issued by NJDOE on *EDA Accounting* and on *Capital Reserve Accounting and Recording*. The proper accounting procedures related to capital projects are included in Chapter 11 of the GAAP Technical Systems Manual.

Capital Project Approval under Educational Facilities Construction Financing Act (EFCFA)

Under EFCFA, effective July 18, 2000, districts may not advance a school facilities project for which it is seeking state support or an other capital project (as defined in *N.J.A.C.* 6A:26-1.1), until the school district has an approved LRFP and has received specific project approval of the school facilities or other capital project. Only school facilities projects approved under the waiver process or approved as an emergent school facilities project under *N.J.A.C.* 6A:26-3.16 may proceed without an approved LRFP. Districts which have begun a school facilities project or other capital project after the passage of EFCFA, should have available for auditors a copy of the DOE final determination letter (approval of the LRFP) and a copy of the school facilities or other capital project approval letter. *N.J.A.C. 6A;26-4.8* as amended and effective June 7, 2004, permits districts to advertise for bids before the school facilities project or other capital project has received approval from the Department, but may still not award contracts until approvals are final.

Non-Abbott districts must obtain voter approval or board of school estimate approval for the local amount of the capital project (pursuant to *N.J.A.C.* 6A:26-3.7 and 3.12) or use capital reserve pursuant to *N.J.A.C.* 6A:26-9.1 and the revisions under S1701. State support for the project is available once the district secures financing for the local amount of the project.

Pursuant to *N.J.A.C.* 6A:26-3.7(e) and (g), the bond referendum (or board resolution for Type I or Type II districts having a board of school estimate) must identify the final eligible costs of the project, as determined by the Commissioner of Education, the total costs, state share or state debt service percentage, the local share and the amounts that are in addition to the facilities efficiency standards. If the district is using a combination of school bonds and other financing sources, the referendum question must also include the portion of the local support to be raised through other revenue sources, listing separately each source and the amount from that source. This includes gifts, grants, private sources and/or municipal surplus.

Unexpended Bond Proceeds

A capital project is considered completed for the purposes of determining unexpended bond proceeds when the project has received its certificate of completion from the contractor; all retainage has been liquidated; and a permanent certificate of occupancy has been received, if applicable (*N.J.A.C.* 6A:26-4.6(a)).

Pre-EFCFA

Any proceeds of school bonds issued by the district for a school facilities project prior to the effective date of EFCFA, and that received no funding under EFCFA except for retroactive funding received pursuant to *N.J.A.C.* 6A:26-13.1(b), or issued by the district for an other capital project (as defined under *N.J.A.C.* 6A:26-1.2), which remain unspent upon completion of the capital project, shall be disposed of by the district in accordance with *N.J.S.A.* 18A:24-47 et seq.

1. Unexpended balances may remain in the capital projects fund for six years after the time of issuance or sale of bonds.
2. Within six years of issuance or sale, if a new purpose(s) for the unexpended balances is determined, the board of school estimate, capital projects review board, or voters may approve the change in purpose by resolution or ballot question. The resolution or ballot question for the new purpose shall receive Commissioner approval if the bonds mature beyond the period prescribed for the new purpose(s) by *N.J.S.A.* 18A:24-5.
3. If no new purpose for the unexpended balances is determined within the six years from issuance or sale, the board of education may transfer the funds to either the general fund or debt service fund by board resolution. To meet the criteria for no new purpose, the district's budgeted appropriations and actual expenditures for the year of the transfer may not reflect capital outlay spending.
4. After six years of issuance or sale, unexpended balances must be transferred to either the general fund or the debt service fund by board resolution.

EFCFA

1. Pursuant to *N.J.A.C.* 6A:26-4.6(c), any proceeds of school bonds (or other revenue sources transferred to the capital projects fund pursuant to N.J.A.C. 6A:26-4.1) issued by the district for the purpose of funding a non-SCC constructed school facilities project after the enactment of EFCFA which remain unspent upon completion of the school facilities project (and/or other capital project whose funding was authorized by bonds) shall be used by the district to reduce the outstanding principal amount at the earliest call date or annually reduce the debt service principal payments.
2. If the unexpended proceeds are used to annually make debt service principal payments, the proceeds must remain in the capital projects fund and be appropriated in each subsequent year's budget certified for taxes to reduce the debt service principal payment in full each year until the proceeds are exhausted.

Unexpended Project Funds - Other Funding Sources

1. Upon completion by the SCC of a school facilities project, any local share required to be returned to the district pursuant to *N.J.S.A.* 18A:7G-5(p) and *N.J.A.C.* 6A:26-3.7(h), shall be used by the district to reduce the outstanding principal amount of any school bonds issued by the district for said local share. The principal amount shall be reduced at the earliest call date or annually through the reduction of the debt service principal payments in accordance with *N.J.A.C.* 6A:26-4.6(c).
2. If school bonds were not issued for said local share or the principal amount has been fully repaid, the local share returned shall be recorded as revenue in the district's general fund.
3. Any unexpended transferred capital outlay and/or capital reserve funds remaining after completion of the school facilities project must be returned to the capital reserve account or anticipated as part of the designated general fund balance of the subsequent school year's budget or reserved and designated in the second subsequent year's budget. Refer to Section II-10.13 for further discussion.

Schools Construction Corporation (SCC) Grants under EFCFA

All grants received from the SCC pursuant to *N.J.S.A.* 18A:7G-15 for the state share of approved school facilities projects, except for grants received for retroactive funding under *N.J.A.C.* 6A:26-13.1(c) for completed projects that did not issue short term notes, are recorded by project in the capital projects fund along with the corresponding local share. Pursuant to *N.J.A.C.* 6A:26-3.8(a)(3) and 6A:26-9.1(g), local share budgeted in capital outlay or withdrawn from capital reserve must be transferred to the capital projects fund upon execution of the grant agreement with SCC. **Districts may award contracts only after the SCC grant is signed and executed. Revenue for the state share cannot be recorded until the agreement is signed and executed (*N.J.A.C.* 6A:23-2.11(c), GAAP). The corresponding local share is transferred to the capital projects fund only when the agreement is signed.**

<u>General Rules for SCC Grant Recording:</u>

District staff and auditors should refer to the memorandum with attachments issued by NJDOE October 19, 2001, titled *Procedures for Recording and Accounting for Capital Reserves and EDA Grants* for additional guidance and examples on accounting for EDA grants.

Generally Accepted Accounting Principles require that capital grants or shared revenues restricted for capital acquisitions or construction (other than those associated with enterprise and internal service funds) be accounted for in a capital projects fund (Fund 30). SCC grants are capital grants. The following is a summary of procedures to be followed for SCC Grants.

1. As stated in the regulations, the SCC grants (except for some retroactive grants received for projects that were fully locally funded and completed in 2000-01 as explained in (4) below) plus the local support are to be recorded in the capital projects fund. (*N.J.A.C.* 6A:26-4.1(a) and (b)).

2. If a non-referendum project receives an SCC grant, per regulations, the grant must be accounted for in Fund 30 and the transfer of local funding sources (capital reserve, capital outlay) to Fund 30 should occur upon execution of grant agreement. (*N.J.A.C.* 6A:26-4.3(a) and (b)).

3. If the capital project is approved via referendum question, upon voter approval of referendum, which should have included all other local funding sources (e.g. capital reserve, surplus), any local sources identified in the question should be transferred to Fund 30. Upon issuance of the bond, bond proceeds would be recorded, along with the local funding sources, and SCC grant in Fund 30. (*N.J.A.C.* 6A:26-4.1(d)).

4. For capital projects that received retroactive grants in 2002-03 that were fully funded locally (Fund 12 and/or Fund 20 - early childhood program aid – no referendum question) and completed in a prior year, the SCC retroactive grant received in 2002-03 is to be recorded in the corresponding fund that originally funded the project.
   - If completed in a prior year using capital outlay and/or early childhood program (ECP) funds, the grant should be recorded in Fund 11 as miscellaneous unrestricted state aid with a
   - Transfer to Fund 20 (general fund transfer) of the proportionate share of the project paid from ECP monies.
   - SCC retroactive grants reimbursing early childhood program funds must be used for early childhood programs and services in Fund 20.

5. For capital projects eligible for retroactive grants where the anticipated amount of the grant was funded with bond anticipation notes and the local funding source was capital outlay, the SCC grant is to be recorded in Fund 30 to repay the notes.

6. For retroactive grants received for referenda approved projects, the grant should follow general rules for recording and accounting for SCC grants in Fund 30 as described above in 1-3 and under the regulations. (*N.J.A.C.* 6A:26-4.1 et seq.).

Overexpenditures

A number of situations have been reported to the department where local school districts overexpended a capital projects fund authorization and in some cases used unauthorized methods to fund the overexpenditure. In managing capital projects, the Business Administrator must certify the availability of funds before the board can award contracts and/or a change order on a capital project that increases the cost of the project. (*N.J.A.C.* 6A:26-4.9(a)(3)). In no instance can approval of change orders increase the cost of the project above the bond referendum approved amount.

Overexpending a capital project authorization has serious consequences. Under the New Jersey Code of Criminal Justice, it is a crime for a public official or employee to knowingly disburse, order, or vote for the disbursement of moneys or incur obligations in excess of appropriations or an amount limited by law (See *N.J.A.C.* 6A:26-4.5 and Division of Finance Policy Bulletin 200-11 issued July 1991). The Department will notify the Office of the Inspector General and may notify the Director, Division of Criminal Justice if an over-expenditure/deficit is detected in a capital project. A district over-expending the capital projects fund may also be subject to a reduction in its state aid and other actions pursuant to N.J.A.C. 6A:23-2.11 and N.J.A.C. 6A:26-14.1 et seq. if applicable.

In the event that local school districts overexpended capital projects funds or otherwise violated the procedures described by *N.J.A.C.* 6A:23-2.11 and Division of Finance Policy Bulletin 200-13 issued October 1992, auditors must include appropriate comments and recommendations and the amount in the Auditor's Management Report.

Rebatable Arbitrage

The interest paid on debt issued for public purposes by school districts is not generally subject to federal taxation. Accordingly, purchasers of securities are prepared to accept a lower rate of interest on tax-exempt debt than they would on taxable debt of similar quality and duration. "Arbitrage" occurs when a school district profits from this spread in interest rates by investing funds borrowed at the lower tax-exempt rate of interest in higher yielding, taxable securities.

There are certain exceptions that allow arbitrage earnings and they are defined in the IRS Code Sec. 148. A school district may not be required to remit arbitrage rebate payments until several years into the future, but it still must recognize a liability for rebatable arbitrage as soon as it is both probable and measurable that a liability has been incurred. In calculating the amount of the liability, it should be noted that "excess" earnings of one year may be offset totally or in part by lesser earnings in a subsequent year. Therefore, the liability recognized for the year should be only that portion of the estimated future payment that is attributable to earnings of the current period. Typically, arbitrage rebate payments must be made to the federal government every five years and within 60 days of final maturity.

Guidance issued in the GFOA "Blue Book" – GASB 34 Edition (p. 66) states that "Rebatable arbitrage should not be treated as a reduction of investment revenues in governmental funds: it should instead be treated in the same way as any other claim or judgment."

> *Auditor's Note* – At the close of construction, both the liability for rebatable arbitrage and related assets typically are removed from the capital projects fund and reported instead in the debt service fund.

Secondary Market Disclosures

All school districts should consult with their bond counsel to determine the information disclosures required in accordance with Securities and Exchange Rules, as well as the filing due date and the municipal and state information repository addresses.

Lease Purchase Agreements

Under EFCFA effective July 18, 2000, districts may no longer enter into lease purchase agreements of more than five years duration for the acquisition of a site and building; the acquisition of a site for the construction of new school facilities; or to make additions, alterations renovations and improvements to existing buildings. Lease purchase agreements in excess of five years duration entered into prior to July 18, 2000 may continue in effect through the term of the agreement (*N.J.A.C.*6A:26-10.8).

Districts may reference the 2001-02 Audit Program for specific details relating to pre-EFCFA lease purchase agreements (greater than 5 years) involving certificates of participation (COPS), such as accounting, disclosure requirements, and advance refunding of the agreements. The 2001-02 Audit Program is available on the NJDOE web site http://www.nj.gov/njded/finance/fp/audit/.

Under EFCFA, a district may acquire improvements or additions to school facilities through lease purchase agreements of five years or less provided that the lease purchase agreement provides for the funding in full to the district upon commencement of construction of the school facilities project. A district may utilize a lease purchase agreement of five years or less to fund the local support of a school facilities project. The Commissioner will only approve a lease purchase of five years or less which does not include excess costs as defined under *N.J.A.C.* 6A:26-1.1. A lease purchase agreement of five years or less for improvements or additions to school facilities project that includes excess costs or to an other capital project must be approved by the voters, board of school estimate or capital project review board. Under EFCFA, a district may also acquire equipment through a lease purchase of five years or less but such acquisition does not require Commissioner or voter approval. Lease purchase agreement payments for five years or less are to be recorded as an expenditure of the general fund. Districts and auditors should reference *N.J.A.C.* 6A:26-10.1 et seq. for lease purchase agreements or approval procedures to refinance a lease purchase agreement.

Accounting and Reporting Requirements: The Codification Section L20.103 states that "subject to the accounting and financial reporting distinctions of governmental funds, the criteria of FASB Statement No. 13, *Accounting for Leases*, as amended and interpreted, should be the guidelines for accounting and financial reporting for lease agreements...".

SECTION II – SPECIFIC COMPLIANCE
FUND 40 DEBT SERVICE FUND

District Taxes

District taxes must be recorded in the fund for which they were voted (Type II) or were certified by the Board of School Estimate (Type I). Debt Service requirements in Type II districts are certified directly by the secretary. In Type I districts the school debt service is part of the municipal budget and not reflected in the Type I school district's CAFR. Additional amounts certified to the county board of taxation after the issuance of tax bills by the municipality will be shown as an adjustment on the district's subsequent year's certificate and report of school taxes. These adjustments are generally the result of additional certifications for unanticipated debt service expenditures and should be reported as revenue via the accrual of a tax levy receivable.

The auditor should comment on any uncollected taxes as of June 30th (other than the special accruals referred to above), and make a recommendation that the board of education request the remittance of the balance from the municipality.

Debt Service Aid

Districts were notified of debt service state aid for the 2003-04 budget in February 2003 and provided with the state aid printouts CEIFA-SA17A and CEIFA-SA17B. Revised debt service state aid printouts for 2003-04 aid were run and distributed in February 2004 with reports for the 2004-05 state aid. The revised CEIFA-17A or 17B for 2003-04 will show the adjusted total debt service aid amount for that year. The amount of the adjustment for 2003-04 is shown at the bottom of the 2004-05 CEIFA-SA1NET distributed in February 2004. The auditor should obtain a copy of the Debt Service Aid reports (SA17A and SA17B) for both 2003-04 and 2004-05.

For a complete explanation of these two reports, auditors should refer to the Explanatory Notes for the SA17A and SA17B Reports, Debt Service Aid for the 2003-04 Fiscal Year distributed to school districts with the debt service aid printouts of February 2003.

The entry to establish the accounts receivable and recognize the deferred revenue for an increase in Type II debt service aid is shown below. No entry is required to revise the debt service budget since all debt service revenue changes are deferred until 2004-05.

Debt Service Fund
Dr. Intergovernmental Accounts Receivable – State (A/C 40-141)
Cr. Deferred Revenues (A/C 40-481)

Rebatable Arbitrage

Refer to Section II-30 for guidance on reporting rebatable arbitrage.

Budget Transfers

In accordance with *N.J.S.A.* 18A:22-8.2, no transfer may be made under this section from appropriations or surplus accounts for interest and debt redemption charges or items classified as general fund expenses except to other items so classified, or to the capital projects fund to supplement the proceeds from a bond authorization or lease purchase agreement upon application to and a formal finding by the commissioner that the transfer is in the best interests of both the students and taxpayers of the district. See the 2003-04 Budget Guidelines, page 149 for discussion on transfers from surplus to supplement bond proceeds for a capital project. Pursuant to *N.J.S.A.* 18A:7G-31(c), a district board of education may, by board resolution, transfer capital reserve funds to the debt service fund for the purpose of offsetting principal and interest payments for bonded projects which are included in the district's long-range facilities plan.

SECTION II - SPECIFIC COMPLIANCE COMPONENT OF FUND 60 - PERMANENT FUND

The permanent fund is a new governmental fund under GASB 34 financial reporting. It is used to report resources that are legally restricted so that only the earnings they generate, and not the resources themselves, may be used to support the district's programs. Resources reported as non-expendable trust funds prior to GASB 34 should be reported as a permanent fund if the district has an ownership interest in the assets.

Examples of resources accounted for and reported in a permanent fund include:

- The district has received a large bequest from the estate of a wealthy benefactor. The corpus of the donation cannot be spent, but instead is required to be invested to provide earnings that are restricted for a special use identified by the benefactor, e.g., maintenance of the libraries.

- A local resident has donated investments with the stipulation that only the earnings of the investments may be used to purchase musical instruments for the schools.

A permanent fund does not include private-purpose trust funds, which are used to report situations in which the district is required to use the principal or earnings for the benefit of those outside the district (individuals, private organizations, or other governments), not for district purposes. See Section II-60 for treatment of trust funds in the fiduciary fund section of the financial statements.

SECTION II – SPECIFIC COMPLIANCE
FUND 50 PROPRIETARY FUNDS

Proprietary funds are used to account for district activities that are similar to business operations in the private sector. They are not used to account for the normal operations of a district regardless as to whether the operations include services provided to outside parties that are offset by revenues such as tuition or adult education fees. There are two categories of proprietary funds -- enterprise funds and internal service funds. The use of these fund types should be consistent with GAAP (GASB Codification 1300.104). Additional guidelines for districts using the internal service fund to account for shared services are outlined *N.J.A.C.* 6A:23-2.13.

There is little change in the proprietary financial statements resulting from GASB 34. Capital Contributions are not reported as a separate component of net assets in the *Statement of Net Assets*, but continue to be reported as such in the funds statements. District staff and auditors should refer to GASB 34, paragraphs 91 through 105 for guidance on proprietary fund financial statements.

Enterprise funds:

Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business operations. The most common examples of enterprise funds in New Jersey school districts are those established to account for the food services program of the district and latchkey programs. **All the expenses of these operations are accounted for in the funds with any board contribution shown as a transfer to cover deficit in the general fund and as an operating transfer in the enterprise fund.**

> *Auditor's Note* – The Transfer to Cover Deficit included in the general fund **must** reconcile to the Operating Transfer – Board Contribution reflected in the enterprise fund. The department has included an edit in the Audsum diskette to identify any discrepancy between the reported amounts and recommends completing the Audsum diskette prior to filing the CAFR. The Transfer to Cover Deficit should be reflected as an Other Financing Use on Exhibit B-2 in the general fund column of the Governmental Funds *Statement of Revenues, Expenditures, and Changes in Fund Balances* and an operating transfer out on the C-1 *General Fund Budgetary Comparison Schedule*.

Food Service – Enterprise Fund

Boards of Education may contract with food service management companies (FSMC) to equip, supply and operate cafeterias without profit to the district pursuant to *N.J.S.A.* 18A:33-3. Every contract for the services of a food service management company should meet federal standards and procurement requirements pursuant to Title 7 of the Code of Federal Regulations pursuant to *N.J.S.A.* 18A:18A-42.1. All districts rebidding their FSMC Contract must rebid pursuant to the Public School Contracts Law, *N.J.S.A.* 18A:18A-1 et seq. as amended by P.L. 1999, c.440.

The most widely used contract method in New Jersey is referred to by the *Accounting Guide for Government Contracts* as the "cost plus a fixed fee (management fee) contract." The food service management company receives a set fee for managing the food service operation and the board is liable for the reimbursement of all costs incurred. Regardless of the contract method, the local board of education is considered the School Food Authority. Federal regulations prohibit contracts that permit all receipts and expenses to accrue to the food service management company. Even if federal reimbursements are not received, schools using management companies and retaining liability for costs incurred are considered the School Food Authority.

As School Food Authorities, daily cash sales and State and Federal reimbursements are school moneys and subject to the State's school laws. Management companies may handle the preparation of food, placing of orders for food and supplies and other associated administrative duties, but they are not permitted under state law to administer or hold school funds.

The following procedures should be implemented in order to comply with state laws for administering school moneys.

1. The income from daily cash sales and State and Federal reimbursements must be under the control of the treasurer of school moneys in any bank or banking institution of this state designated by the board of education as a depository of school moneys. Such funds may be deposited in the Board’s general operating account. A separate food service account is not required. (*N.J.S.A.* 18A:17-34)

   Receipts and disbursements of food service funds must be separately accounted for in the records of the treasurer and board secretary. The board secretary should maintain the cash records in accordance with The Uniform Minimum Chart of Accounts (Handbook 2R2).

   When the board budgets funds in its general fund budget in account 11-000-310-930, Transfers to Cover Deficit, those funds may be transferred to the Enterprise Fund at the end of the year for the actual amount, if any. If made prior to the end of the year, any amount of the transfer not needed for a deficit may be refunded to the general fund.

2. The board may by resolution designate the board secretary or another person to approve payments without board approval to expedite the payment process. All such payments must be issued on properly signed warrants and subsequently ratified by the board. The board's resolution may limit the authorization to certain purposes such as the school food service reimbursements and may also limit the dollar amount per payment or month. (*N.J.S.A.* 18A:19-1, 2, 4 and 4.1)

3. Loans or advances from the board to a food service management company are prohibited. All claims and demands must state that articles have been furnished or services rendered before payment can be made. (*N.J.S.A.* 18A:19-3)

4. Food service management companies may negotiate the cost reimbursement dates with the board. However, no interest may be charged on payments which are not made within the negotiated dates.

5. The food service management company must provide itemized claims for services and goods to the board secretary for reimbursement.
   a) The food service management company should process payroll data in such a way that the board secretary can reimburse it in time for payroll checks to be issued. A one week lag between payroll period and check disbursement should provide sufficient time for all necessary verifications and payments.
   b) The food service management company must submit an itemized claim for reimbursement for all goods and services. Reimbursement claims for payroll should include either a copy of the company's payroll for those employees providing service to the district or an itemized listing of employees, check numbers and date, hours worked and earnings. In the latter scenario, payrolls and support documentation must be made available whenever requested by the board secretary and for the annual audit.

When the food service management company purchases specifically for the school district, reimbursement claims for goods should list invoice numbers, dates, vendor names and amounts (Sample 1 on page II-50.4). If the food service management company purchases food in bulk for a number of districts, it may use the above method allocating invoice amounts between districts based on the percentage of each district's student enrollment (or participation) to the total enrollment for all schools (Sample 2 in Section II, Chapter 50). It may also use a per-meal cost calculation based on the total amount of the invoices divided by the total meals served to all districts. Each district's pro-rata share of the costs would be the per-meal cost multiplied by the meals served in each district (Sample 3 in Section II, Chapter 50).

When a food service management company submits an itemized claim for reimbursement, it is not necessary to provide vendor invoices. However, they must be made available whenever requested by the board secretary and for the annual audit.

6. The board of education and the food service management company should work closely to minimize the time of reimbursements and to avoid cash flow problems. However, a food service management company may need to establish a line of credit if the timing of reimbursements is not sufficient to make its payrolls. Interest paid is an allowable cost of the contract in such situations.

The foregoing procedures are recommended by the department to comply with the state's statutes for administering school funds. However, these procedures do not replace but rather supplement the requirement contained in 7 CFR 210.16 that all books and records of the food service management company pertaining to the school food service program shall remain the property of the school district. Auditors must include appropriate comments and recommendation in the event that funds are not properly administered as described in Division of Finance Policy Bulletin 200-12.

SAS #70 Reports

In accordance with SAS #70, as amended by SAS #88, school district auditors may evaluate the internal controls of a food service management company by relying upon the opinions of a "service auditor" of the food service management company's internal control system. To that end, school districts must only contract with food service management companies that can provide an audit opinion on said company's system of internal control. Beginning in 1994-95, all food service management company bid specifications, contracts and/or addenda must include this requirement as a condition of bid qualification.

SAMPLE 1

Foodland Food Services
123 Broad Street
Anytown, NJ 08000
609-123-4567

October 15, 200X
Invoice #123456

New City School District
Highland Street
Old Town, NJ 08111

For reimbursement of costs incurred related to the provision of food services for the schools of the New City School District during the month of September 200X. The costs incurred are listed below:

Invoice #	Date	Vendor Name	Amount
06932	8/31/0X	Bakeland	$2,398.61
12555X	9/02/0X	Murray's Meats	6,779.38
431182	9/03/0X	Polly's Produce	796.54
218812	9/07/0X	Dan's Dairy	877.32
06988	9/07/0X	Bakeland	531.89
12682X	9/07/0X	Murray's Meats	153.90
431906	9/13/0X	Polly's Produce	591.83
219601	9/24/0X	Dan's Dairy	877.32
		Total	$13,006.79

Please remit the above amount by November 15, 200X. The listed invoices are available for audit and review. I certify that the within invoice is correct in all its particulars, that the described goods or services have been furnished or rendered and that no bonus has been given or received on account of said invoice.

Franklin Chief
President
Foodland Food Services

SAMPLE 2 (1 of 2)

Foodland Food Services
123 Broad Street
Anytown, NJ 08000
609-123-4567

October 15, 200X
Invoice #123456

New City School District
Highland Street
Old Town, NJ 08111

For reimbursement of the New City school district's pro-rata share of costs related to the shared food services program provided by our company. The allocation is based on the number of students participating at each school. See the attached cost allocation detail supporting the amount charged.

For the month of September 200X $3,107.21

Please remit the above amount by November 15, 200X. The invoices listed on the attached cost allocation are available for audit and review. I certify that the within invoice is correct in all its particulars, that the described goods or services have been furnished or rendered and that no bonus has been given or received on account of said invoice.

Franklin Chief
President
Foodland Food Services

SAMPLE 2 (2of 2)

NEW CITY SCHOOL DISTRICT FOOD SERVICES ALLOCATION

Invoice #	**Date**	**Vendor Name**	**New City**	**Upper**	**Lower**	**Middle**	**Total**
			19.7%	**14.1%**	**27.8%**	**38.4%**	**100.0%**
6932	8/31/200X	Bakeland	$208.09	$148.94	$293.65	$405.61	$1,056.29
12555X	9/2/200X	Murray's Meats	689.23	493.31	972.62	1,343.48	3,498.64
431182	9/3/200X	Polly's Produce	176.45	126.29	249.	343.94	895.68
218812	9/7/200X	Dan's Dairy	632.22	452.5	892.17	1,232.35	3,209.24
6988	9/7/200X	Bakeland	118.77	85.01	167.61	231.51	602.9
12682D	9/7/200X	Murray's Meats	692.86	49591	977.75	1,350.55	3,517.07
431906	9/13/200X	Polly's Produce	112.21	80.31	158.34	218.71	569.57
219601	7/13/200X	Dan's Dairy	477.38	341.68	673.66	930.52	2,423.24
		Total	$3,107.21	$2,223.95	$4,384.80	$6,056.67	$15,772.63

	No. of Students Participating	Percentage
New City	630	19.7%
Upper	452	14.1%
Lower	889	27.8%
Middle	1,230	38.4%
Total	3,201	100.0%

SAMPLE 3 (1 of 2)

Foodland Food Services
123 Broad Street
Anytown, NJ 08000
609-123-4567

October 15, 200X
Invoice #123456

New City School District
Highland Street
Old Town, NJ 08111

For reimbursement of the New City school district's pro-rata share of costs related to the shared food services program provided by our company. See the attached per meal cost calculation supporting the amount charged.

For the month of September 200X	
1,598 meals @ $2.45 meal	$3,910.60

Please remit the above amount by November 15, 200X. The invoices listed on the per meal cost calculation are available for audit and review. I certify that the within invoice is correct in all its particulars, that the described goods or services have been furnished or rendered and that no bonus has been given or received on account of said invoice.

Franklin Chief
President
Foodland Food Services

SAMPLE 3 (2 of 2)

NEW CITY SCHOOL DISTRICT FOOD SERVICES ALLOCATION									
					Invoice				
Invoice#	Date		Vendor Name		Amount				
6932	8/31/200X		Bakeland		$ 2,398.61				
12555x	9/2/200X		Murray's Meat		6,779.38				
431182	9/3/200X		Polly's Produce		796.54				
218812	9/7/200X		Dan's Diary		877.32				
6988	9/7/200X		Bakeland		531.89				
12682X	9/7/200X		Murray's Meat		153.90				
431906	9/13/200X		Polly's Produce		591.83				
219601	7/13/200X		Dan's Diary		877.32				
			Total		$13,006.79				
			School District		No. of Meals		Price/Meal		Amount
			New City		1,598		$ 2.45		$3,910.60
			Upper		1,299		$ 2.45		3,178.89
			Lower		1,243		$ 2.45		3.041.85
			Middle		1,175		$ 2.45		2.875.44
			Total		5,315		$ 2.45		$13,006.79

Child Nutrition Program Requirements

The Bureau of Child Nutrition Programs is revising its audit policy regarding the review of School Food Services to comply with OMB Circular A-133 Revised (OMB A-133). OMB-133 was revised to raise the audit threshold for all recipients, including state and local governments, to $500,000. The provisions of OMB Circular A-133 Revised are effective for fiscal years ending after December 31, 2003.

Districts and their auditors should refer to the sample Proprietary Fund statements (Exhibits B-4, B-5, and B- 6) on the NJDOE web site: http://www.state.nj.us/njded/finance/fp/gasb34/. When a district has more than two programs in the Proprietary Fund, combining statements should be prepared. Please refer to the sample format for School Food Service Fund Exhibits F-1, F-2 and F-3 in Financial Reporting for New Jersey School Districts, A Sample Comprehensive Annual Financial Report, The CAFR (issued August 1999) for combining statements. The Proprietary Fund combining statements follow the same format but are labeled Exhibits G-1, G-2 and G-3.

Auditors should report on the condition of the financial transactions and statistical records of the School Food Service Fund, including a review of monthly reimbursement vouchers, meal count records, Edit Check Worksheets, and eligibility applications. **Determine whether there are controls providing reasonable assurance that all meals reported to the state agency for reimbursement are based on accurate counts and are served to eligible children.**

Please Note: Effective with October 2003, monthly reimbursement claims were entered on-line using the Child Nutrition Program's website via the myNewJersey portal. This on-line system provides payment status, payment logs and a monthly report summarizing meals claimed by site. The auditor may request these reports from the district.

1. Suggested audit procedures to ensure that reimbursement received is supported by source documents.

   a) ELIGIBILITY APPLICATIONS – Review eligibility applications to evaluate completeness of required information and verify eligibility determination. Any incomplete free or reduced price applications should be given to the determining official for completion. Findings related to the free and reduced eligibility determination should be reported in the Auditor's Management Report (AMR) in the School Food Service section. Free applications that are not available or incorrectly determined must also be cited as an exception under Demonstrably Effective Program Aid, Early Childhood Program Aid, and Instructional Supplement Aid where applicable.

      Applications may also have been determined through the Direct Certification Process. Please refer to May 2003 Memo, "Direct Certification for Free Meal/Free Milk Benefits for School Year 2003-2004."

      Schools participating in Provision 1 or 2 are not required to collect eligibility applications annually. Please refer to eligibility requirements set forth in the Memo, "Application Process for Provisions 1 and 2".

      Multi-Child/Household Application for Free and Reduced Price Meals School Year 2003-04 - Sponsors were given the option of choosing to utilize the single or multi-child format. If multi-child option was selected sponsors had to certify that they would comply with minimum standards and procedures stipulated on the "Request & Certification" form.

   b) MEAL COUNT RECORDS - Review meal count records on a school-by-school basis to verify meals claimed on reimbursement vouchers. Edit Check Worksheet(s) must be completed for every reimbursement voucher submitted and the required comparisons made before completing the reimbursement voucher. Any meals denied free or reduced priced eligibility should be credited at the paid rate of reimbursement.

Unsupported reimbursement must be cited as a finding of noncompliance and a financial assessment identified on the Schedule of Meal Count Activity (Overclaim/Underclaim). Provide pertinent detail, i.e. school, month.

2. Verification Regulations issued by the United States Department of Agriculture require pricing sponsors of the National School Lunch and School Breakfast Programs to verify a minimum number of approved applications on file as of October 31 of each school year. Sample selection and verification may begin earlier based on projections done by school officials. Each sponsor must select one of the two following methods to satisfy the verification requirements:

   a) RANDOM SAMPLE - The lesser of 3 percent or 3,000 of approved applications selected randomly; ***OR***

   b) FOCUSED SAMPLE - The lesser of 1 percent or 1,000 of total approved applications selected from nonfood stamp households with income near the eligibility levels, plus the lesser of .5 percent or 500 of approved applications which substituted a food stamp household or an AFDC case number for income information. Verification of food stamp households consists of confirming current receipt of food stamp benefits.

   All verification activity must be completed by December 15 of each school year. The auditor's review of eligibility applications should include a review of the verification file to ensure that this process was established. It is not necessary for the auditor to review the contents of the verification file.

3. Expenditures of school food service revenues should be limited to allowable school food service direct and indirect costs. Review vendor invoices and verify labor costs. Determine that inventory records on food and supply items are currently maintained. Review time sheets and verify labor cost. Verify that payroll records are maintained.

4. Net cash resources may not exceed three months average expenditures. In the event that net cash resources exceed three months average expenditures for the School Food Authority's nonprofit school food service, the State Agency may require the School Food Authority to reduce children's prices, improve food quality or take other actions designed to improve the nonprofit school food service. (REF 7CFR 210:15)

   Net cash resources are defined as all monies that are available to, or have accrued to a School Food Authority's nonprofit school food service at any given time, less cash payable. Such monies may include, but are not limited to, cash on hand, cash receivable, earnings on investments, cash on deposit and the value of stocks, bonds or other negotiable securities.

5. The auditor should comment on whether Food Distribution Program (formally U.S.D.A.) commodities were received. If the school district is utilizing a vendor to provide meals, review evidence that the market value of Food Distribution Program donated commodities was credited on monthly invoice statements.

6. Auditors should verify that financial arrangements and other provisions in the Food Service Management contract have been complied with; if not, cite exception.

7. The United States Department of Agriculture does not permit increases in reimbursement for revised vouchers received after 60 days without proper verification. However, payment can be

considered if the underclaim is verified in an audit or administrative review. Auditors are instructed to verify any underpayments as a result of late revisions in the audit report under the Schedule of Findings and Questioned Costs. Please note that such payment is subject to approval.

8. The following memorandums and attachments for the school year 2003-04 are on file at local school district offices to be referenced by the auditor:

a) September 2003-
- Public Reimbursement Rates for Child Nutrition Programs/Maximum Meal and Milk Prices
- Nonpublic Reimbursement Rates for Child Nutrition Programs/Maximum Meal and Milk Prices
- Residential Institution Reimbursement Rates for Child Nutrition Programs/Maximum Meal and Milk Prices

b) September 2003- Verification Workshop Schedule

c) September 20, 2003 – Reimbursement Voucher Package 2002-2003: Changes, Instructions, Rates and Timely Submission of Reimbursement Vouchers.

d) January 31, 2003 - Securing Base Year Food Service Management Company (FSMC) Contracts for School Year 2003-04

<u>Attachments</u>
Response and Projected Operating Statement (Form #23)
Bid/Proposal Comparison Sheet (Form #24)
Appendix B-FSMC Contract Required Language Checklist (Form #17)
Base Year Contract Checklist (Form #15)
Suggested Timeframes for the FSMC Quotation/Bid Process (Form #36)
Food Service Data (Handout #147)
Suggested Guidance for Soliciting Proposals (Handout #148)
Cost Responsibility Summary (Form #149)
Reference Materials Relating to FSMC (Handout #34)
State Agency Approval of FSMC Contracts and Addenda (Handout # 137)

e) March 1, 2003 – SFA's Renewing FSMC Contracts for 2004

1 - Early Approval of Food Service Management Company (FSMC) Addendum and Registered Food Service Management Company Directory
2 - Attachment- School Food Authority/Food Service Management Company Renewal Addendum Checklist (Form 16)

March 15, 2003 – All SFAs with Self-Operated Food Service Programs Considering Employing a FSMC for School Year 2003-04

March 1, 2003 – SFAs Awarding Base Year FSMC Contracts for FY 2004

1 - Registered Food Service Management Company (FSMC) Directory
2 - Early Approval of Food Service Management Company (FSMC) Contracts
Attachment - School Food Authority/Food service Management Company Base Year Contract Checklist (Form 15)

f) Application Process for Provisions 1 and 2

g) May 2003 - Direct Certification for Free Meal/Free Milk Benefits for School Year 2003-04

h) Multi-Child Family/Household Application for Free and Reduced Price Meals School Year 2003-04

i) Fiscal Year 2004 Application for Free and Reduced Price Meals or Free Milk

j) Fiscal Year 2004 Income Eligibility Guidelines

k) Maximum Prices for Student Meals/Snack and Variable Pricing for School Year 2003-2004

l) June 2003 - Program Extensions for the Summer 2003 Program Changes to be Effective Beginning 9/1/2003

Date issued 7/04

FISCAL YEAR 2004
JULY 1, 2003 – JUNE 30, 2004
REIMBURSEMENT RATE BREAKDOWN

NATIONAL SCHOOL LUNCH RATES

REGULAR RATE SFA's w/less than 60% of Free and Reduced Lunch			
	FEDERAL	STATE	TOTAL
FREE	2.19	0.10	$2.29
REDUCED	1.79	0.10	$1.89
PAID	0.21	0.04	$.025

HIGH RATE (EXTRA 0.02 CENTS) SFA's w/more than 60% of Free and Reduced Lunch			
	FEDERAL	STATE	TOTAL
FREE	2.21	0.10	$2.31
REDUCED	1.81	0.10	$1.91
PAID	0.23	0.04	$.027

SCHOOL BREAKFAST PROGRAM

REGULAR RATES			
	FEDERAL	STATE	TOTAL
FREE	1.20	0.10	$1.30
REDUCED	0.90	0.10	$1.00
PAID	0.22	0.10	$ .32

SEVERE NEED RATES			
	FEDERAL	STATE	TOTAL
FREE	1.43	0.10	$1.53
REDUCED	1.13	0.10	$1.23
PAID	0.22	0.10	$ .32

AFTER SCHOOL SNACKS

AT RISK/ AREA ELIGIBLE	0.60
NON- AREA ELIGIBLE	
FREE	0.60
REDUCED	0.30
PAID	0.05

SPECIAL MILK PROGRAM

FREE	Average cost per half pint * Based on Individual SFA's costs
PAID	0.13

Commodity Value $.1575

***SFA'S=SCHOOL FOOD AUTHORITIES**

Internal Service Funds

Districts should use internal service funds to account for the financing of goods or services provided by one department or office to other departments or offices of the district board of education, or to other district boards of education and governmental units, on a cost-reimbursement basis. Internal service funds are cost accounting and distribution entities, and are intended to "break even" annually and/or over a period of years. The use of an internal service fund does not provide additional revenue or expenses to the district but acts as a means to document the sharing of the costs. Use of this fund replaces the prior common practice of "refunding" expenditure accounts for shared services. Some activities that may be accounted for in an internal service fund are central purchasing and warehousing, central motor pools, central printing and duplicating or central data processing departments. Joint transportation agreements where the lead district uses its own employees and buses are accounted for in an internal service fund. Joint transportation agreements where the lead district contracts with a vendor are accounted for in the general fund.

Arrangements for sharing the costs of administrative and other non-instructional personnel and related costs under joint agreements where the employees remain under the employment of one lead district would also be accounted for in an internal service fund in the records of the lead district. Each of the "sharing" districts, including the employing lead district, should reflect their agreed-upon portion of the costs in the general fund. For the employing district, that cost would be budgeted as a salary expenditure. The "sharing" districts would account for the payments made to the lead district as a contracted service under the appropriate function. If the shared employees have employment contracts with each of the districts involved, each district's share of the employees' salary and related costs would be budgeted and expended against the appropriate salary and other accounts and there would be no need for any of the districts involved to establish an internal service fund.

- The district board of education providing the shared service shall allocate the costs on a user charge basis to all participating entities on an annual basis at a minimum.
- User charges should be reported by entities or funds being serviced by the internal service fund in the applicable line item account for the goods or services received.
- Sales and purchases of goods and services for a price approximating their external exchange value should be reported as revenues ("Services Provided to Other Funds"). The total user charges should approximate the total costs of the internal service fund.

Local school district auditors should refer to Chapter 14 of the GAAP Technical Systems Manual for additional guidance. As a reminder, the costs of instructional programs, including regular, special, or adult education, should be accounted for in the general fund. The one exception would be those districts which contract with the Department of Education to run its Regional Day Schools.

Self-insurance (Risk Financing):

Self-insurance is the practice of a school district controlling and self-directing the costs of administering an insurance program while retaining a risk of loss. GASB Statement Number 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, establishes the accounting and financial standards for risk financing and self-insurance related activities. If a district accounts for all of its risk financing activities in a single fund, it is recommended that the Internal Service Fund be used. However, GASB Statement 10 paragraph 63 also permits the use of the general fund for such purposes. The Government Finance Officers Association's publication *Governmental Accounting, Auditing, and Financial Reporting* (the "Blue Book") page 101 states, "If a government chooses to use an internal service fund to account for its risk financing activities, interfund premiums should be classified as interfund services provided (a reciprocal interfund activity). As a result, premiums received by the internal service fund should be reported as revenues. Unless excess revenues are justified, premiums in excess of probable and measurable losses incurred must be reported as an operating transfer (a nonreciprocal interfund activity) rather than as revenue."

The Internal Service Fund reports on the accrual basis and per GASB 10 paragraph 53 should limit liability recognition to probable and measurable losses as of the balance sheet date. For example, worker's compensation losses that have been incurred but not reported (event occurred, but no claim has been asserted at the balance sheet date), are accrued if a reasonable estimate of the loss can be made.

SECTION II- SPECIFIC COMPLIANCE
COMPONENT OF FUND 60 AND FUND 70 - FIDUCIARY FUNDS

Assets that are held in a trustee or agency capacity for external parties and that cannot be used to support the government's own programs are reported as fiduciary funds. Trust funds may be distinguished from agency funds by the existence of a trust agreement, a higher degree of management involvement, and a longer holding period of the fund resources. Agency funds report resources held by the reporting government in a purely custodial capacity.

Fiduciary trust and agency fund activity is not included in the district-wide financial statements (the Exhibit A series) but is reported in the fund statements (Exhibit B7 and B8) as described below. Inclusion of the trust or agency fund resources in the district-wide financial statements might mislead the reader about the financial position of the district since these funds are not available for use by the district.

Trust Funds:

GASB No. 34 eliminates the terminology of expendable and nonexpendable trust funds and identifies three classes of trust funds:

- Pension and other employee benefit trust
- Investment trust funds
- Private-purpose trust funds

Pension and other employee benefit trust funds account for resources held in trust for the members and beneficiaries of the district's employee benefit plans. Investment trust funds report the resources of a combined investment effort among school districts. Private-purpose trust funds encompass other trust fund arrangements for which principal and income benefit individuals or agencies outside of the school district. Examples of a private purpose trust fund are a scholarship fund or a fund that reports the resources of an awards program, funded by contributions from local businesses to provide small cash awards to qualifying high school seniors.

Districts need to evaluate those activities that have been reported as trusts in the pre-GASB 34 Model to determine if they are trusts for purposes of financial reporting under GASB 34. In some instances, districts will need to include the former expendable trusts in the special revenue fund, i.e., if the resources actually benefit the district and are expendable. When funds are legally restricted to the extent that only the earnings, and not the principal, may be used to benefit the district, those resources are reported in the permanent fund.

There are two required trust fund financial statements under GASB No. 34:

- *Statement of Fiduciary Net Assets*
- *Statement of Changes in Fiduciary Net Assets*

Refer to the *Statement of Fiduciary Net Assets* and the *Statement of Changes in Fiduciary Net Assets* (Exhibits B-7 and B-8), the sample fiduciary fund statements, in the Sample Statements section on the NJDOE web site: http://www.state.nj.us/njded/finance/fp/gasb34/ .

Unemployment Trust Fund

When a district elects the reimbursement method (also called the payment in lieu of contributions or pay as you go method, i.e., the state pays the claim and invoices the district for the amount due) for unemployment compensation, the accumulation of funds is reported in a trust/fiduciary fund in the CAFR.

Effective January 1, 1999, a portion of the employee's deductions for unemployment compensation are required to be deposited in the Unemployment Compensation Insurance Trust Fund. This applies to districts that fund New Jersey Unemployment Compensation Insurance under the "Benefit Reimbursement Method". The percentage breakdown for the worker contributions is as follows:

	As of July 1, 2003
Worker Unemployment Contributions:	
	0.325% Submit with Quarterly Contributions Report
	0.100% ***Deposit into individual trust account***
	0.425%

Districts that fund New Jersey Unemployment Compensation Insurance under the "Contributory Method" (Agency fund) will continue to remit the entire employee deduction to the Commissioner of Labor. If you have questions that pertain to withholding and/or filing, it is recommended that you contact the New Jersey Department of Labor at (609) 633-6400.

Section 457 Deferred Compensation Plans

P.L. 2003, c.155 approved August 15, 2003, permits boards of education to establish tax-sheltered deferred compensation plans under section 457 of the federal Internal Revenue Code. Additionally, the act grandfathers any section 457 plan established by a board of education prior to the effective date of this law. The act amends N.J.S.A. 18A:66-127 through 129.

GASB Statement No. 32 *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans* as amended by GASB Statement No. 34 provides authoritative guidance on the reporting of 457 plans. Generally, the district Board of Education must determine whether or not the Board is acting in the capacity as trustee for the plan. Factors such as whether the Board has retained the power to make investment decisions for the plan, approves loans made from plan assets, and approves withdrawals for unforeseen emergencies suggest the Board is acting in the capacity of a trustee.

If the Board is acting as a plan trustee, then the assets of the plan are reported in the fiduciary fund under the category "pension and other employee benefit trust funds." If the district has established a 457 plan but does not hold the assets in a trustee capacity, then those assets are not included in the district's fiduciary fund financial statements. Refer to Section III, Chapter 3 for required note disclosures.

Agency Funds:

Agency funds report resources held and administered by the reporting district in a purely custodial capacity for other governments, organizations, and/or individuals. These funds typically involve only the receipt, temporary investment, and remittance of the resources to external parties. Common examples of agency funds are payroll and student activity funds.

Agency funds are included in a separate column in the *Statement of Fiduciary Net Assets.* Because an agency fund does not have net assets, it is not included in the *Statement of Changes in Fiduciary Net Assets*. The district will continue to present the *Student Activity Agency Fund Schedule of Receipts and Disbursements* in Other Supplementary Information (Exhibit H-3).

Payroll funds: Where a district uses a central payroll system and reports all payroll deductions in an agency fund, the unremitted balances in the agency fund at year-end are reported by the agency fund as liabilities. Refer to Section II-10.2 for discussion on regulations related to third party disbursements (payroll service organizations). The regulations (*N.J.A.C.* 5:30-17 et seq.) are available at http://www.nj.gov/dca/lgs/rules/rulesmenu.shtml.

Student activity funds are reported as agency funds within the CAFR. An arrangement between a student organization and the district whereby the district maintains the cash raised by the student organization is a common example of a student activity fund.

Organizations under the Auspices of the School

Any organization which is officially recognized by the school as part of the activity program of the school district, places at least indirect responsibility for supervision and control of that organization with the board of education. The board should formally approve each fund in its school district. If any fund is an activity carried on by the board, an officer or employee of the board, or an organization of public school pupils conducted under the auspices of the board, the board must assure that financial and bookkeeping controls are established.

The State Board of Education has not prescribed a uniform system of bookkeeping for the activities funds of school districts. *N.J.A.C.* 6A:23-2.14 states, "Each district board of education and charter school board of trustees shall ensure through adoption of a formal board policy that all financial and bookkeeping controls are adequate to ensure appropriate fiscal accountability and sound business practices." This policy shall include but not be limited to, the following minimum requirements:

(1) Receipts shall be detailed showing date, sources, purpose and amount. All receipts should be promptly deposited in the bank. Bank deposits must agree with the receipts in the cash receipt book and must be traceable to definite receipts or groups of receipts.

(2) Disbursements shall be recorded chronologically showing date, vendor, check number, purpose and amount. All disbursements should be made by check and supported by a claim, bill or written order to persons supervising the fund. Checks should bear two or more authorized signatures.

(3) Book balances shall be reconciled with bank balances. Canceled checks and bank statements must be retained for examination by the auditor as part of the annual audit.

(4) Student activity funds shall be classified by school.

(5) Borrowing from the student activity is prohibited.

Local school district auditors should refer to Chapter 15 of the GAAP Technical Systems Manual.

Fund Raising in Schools by Outside Organizations

Organizations such as the United Fund, March of Dimes, etc., may request that moneys be collected. These funds are not subject to audit. Boards of education may give permission for the collection to be made in schools. Any teacher or pupil who serves as a collector does so as a private citizen and not as an employee of the board. Accurate records must be kept but responsibility is to the organization and not to the board of education for the money collected.

In order to avoid misunderstanding, we advise that boards of education that give permission for soliciting in a school building by outside organizations make it clear that the board is not directing the teachers and pupils to collect funds, but merely granting permission to do so. The board is further advised to disclaim any responsibility for the protection of, and the accounting for, the funds to the outside organizations.

Any collector should understand that he/she is collecting voluntarily as a citizen and not as a teacher or pupil, and that the board of education has no responsibility for the protection of moneys so collected.

Some boards may have given permission for depositing funds collected in drives in a school activity account and the issuance of checks thereon to the outside organization. Although this might be a convenience to school personnel who are handling the money collected, it causes an undesirable commingling of funds for which the board should have no responsibility. The commingling of such funds is legally suspect. However, if it occurs the commingled funds are subject to audit by the boards' auditors.

Funds of Teacher Organizations and Parent/Teacher Organizations

The law provides that the books, accounts and moneys of any officer or employee of the board shall be audited. This does not mean that every time a school employee serves as treasurer of an organization that the account must be audited. It is only when money is held for which the board is directly or indirectly responsible that the accounts must be audited. The board has no responsibility for the funds of teacher organizations. A school employee who serves as a treasurer of such an organization does so as a citizen and not as an employee of the board. If moneys were deposited in a central school fund, they would be subject to audit.

Funds Collected by Teachers from Pupils for Immediate Purchase of Items

Teachers may receive money from children to buy magazines, tickets, etc., in bulk to save the children money. It is our opinion that in so doing the teacher represents the children and not the school board and assumes full responsibility for the transactions.

Refer to Section I Chapter 1 for information on GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*.

SECTION II – SPECIFIC COMPLIANCE
CAPITAL ASSETS

Overview

Capital assets include land and land improvements, buildings, furniture, fixtures and equipment, infrastructure items, works of art and historical treasures.

The department notified districts by memorandum dated January 11, 2001 that, effective July 1, 2001, the capitalization threshold used by school districts and charter schools in the State of New Jersey is increased to $2,000. This is a policy set for financial reporting and accounting purposes. Districts may use a lower threshold for asset management and insurance purposes.

Districts were to continue to record the addition and disposition of capital assets in the general fixed asset account group (GFAAG) through 2003-04. Effective July 1, 2004 (2004-05) and all subsequent years, the Uniform Minimum Chart of Accounts for New Jersey Public Schools was reissued to incorporate updates from July 1, 2004 to present and to address changes in financial reporting as a result of GASB 34. Under the revised COA, the GFAAG is no longer reported in fund 80 as fund 80 has been reassigned for trust funds. **Districts are still required to record capital assets and may designate a numeric or alpha fund number in their general ledger which is suitable for their software system (e.g., 100, 99 or CA) or use a separate fixed asset module. The fixed asset ledger should be updated monthly for internal control purposes.**

Reporting Capital Assets

Capital assets are reported at historical cost, including ancillary charges necessary to place the asset into its intended location and condition for use. "Ancillary charges include costs that are directly attributable to asset acquisition – such as freight and transportation charges, site preparation costs, and professional fees. Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charge, if any." (GASB 34, par. 18, as amended by GASB 37, par. 6).

The chart below highlights which statements report capital assets. "N/A" means that statement is not issued for that particular fund type, whereas "No" means that statement is issued for that particular fund type but capital assets are not reported.

Class of capital asset	District-wide statements	Funds statements	Budgetary comparison schedules
Governmental	Y	No	No
Proprietary	Y	Y	N/A
Fiduciary	N/A	Y	N/A

Statement of Net Assets
Report capital assets within the governmental activities column in the district-wide *Statement of Net Assets*. Capital assets of proprietary funds are reported in the business-type activities column of the *Statement of Net Assets*.

Funds Statements
Capital assets used in governmental activities are not reported as assets in governmental funds statements since the governmental funds statements follow the modified accrual basis of accounting and capital assets are not current financial resources. Proprietary fund capital assets are reported in the fund statements since this fund uses the accrual basis of accounting (economic resources). Capital assets of

fiduciary funds are reported in the fund level since the fiduciary funds statements use the accrual basis of accounting. The fiduciary assets are not considered available to the district and therefore are not reported on the district-wide statements.

Capital outlays of the governmental funds are reported as a reconciling item in the *Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities,* which reconciles the net change in government fund balances to the change in net assets of governmental activities.

District staff and auditors may refer to the NJDOE GASB 34 web site for sample statements noted above http://www.state.nj.us/njded/finance/fp/gasb34/outline.shtml#worksheets. District staff and auditors should also refer to the Section II-30, Capital Projects Fund, of this *Audit Program* for related subjects

Capital Leases

Assets acquired under a capital lease are recorded at the inception of the lease. In order to convert the fund financial statements from a modified accrual basis to an accrual basis for the preparation of the government-wide financial statements, the expenditure must be capitalized, any related depreciation expense must be recorded, and the debt must be recognized along with the accrual of any related interest expense.

Construction in Progress

Assets under construction are tracked through Construction in Progress until completion. *N.J.S.A.* 18A:18A-42 provides that purchase orders for construction, reconstruction or rehabilitation of any public building are valid for the length of time authorized for completion of the actual project.

Reporting of Capital Assets Acquired Through Non-cash Grants

Capital assets acquired through non-cash grants are reported only in the district-wide *Statement of Net Assets* at fair market value. This is applicable to buildings constructed for a district by the Economic Development Authority/School Construction Corporation (SCC). Districts are to obtain the June 30 value of SCC constructed assets from the SCC.

Sample Format for the Capital Asset Subsidiary Ledger

As noted in Chapter I-1 of this Audit Program, schedules of capital assets should be prepared prior to audit. The following is a suggested minimum format for districts' use in maintaining records of capital assets, including accumulated depreciation (Accum. Depr.) and depreciation (Depr.):

Classification	N1	N2	Date Placed in Service	Acquisition Cost	Method of Depr.	Life N3	6/30/03 Accum Depr.	7/1/03-6/30/04 Depr. Expense	6/30/04 Accum. Depr.
Buildings:									
School #1			**9/1/97**	**$5,000,000**	**S/L**	**35 yr**	**$833,333**	**$142,857**	**$976,190**
Furniture:									
Desks	**B2**	**P5**	**9/1/97**	**$5,000**	**S/L**	**10 Y**	**$2917**	**$500**	**$3,417**

N1 – Assets should be tagged and maintained by physical location.

N2 – Assets that can be specifically identified to a program or function should be noted with the program code. If assets are not specifically identifiable, the district should note "N/A" in the program column.
N3 - Districts may refer to the table of estimated useful lives (International ASBO) included in Section I-1 of this Audit Program.

Refer to III-6.6 (Audit Checklists and Questionnaire) for capital asset schedule requirements.

Depreciation Expense

The *GASB 34 Implementation Guide* dated April 2000 provides guidance on depreciation expense which is to be reported as a direct expense of the function served. As the number of functions served by an asset increases, the ease, practicality, and usefulness of assigning depreciation to those functions decreases. Therefore, depreciation of assets serving many or essentially all functions is not required to be included in the direct expenses of those many functions. Depreciation of a shared capital asset used by only a few functions can be allocated to those functions using an objective measure for the assignment of cost. For example, building depreciation may be allocated based on square footage assigned to the respective functions. The department recommends districts use the straight line method of depreciation.

SECTION II – SPECIFIC COMPLIANCE
LONG-TERM LIABILITIES

Overview

Long-term liabilities generally include debt issuances, the non-current portion of lease-purchase agreements, capital leases, operating leases with scheduled rent increases, compensated absences, claims and judgments, early retirement incentive programs, and rebatable arbitrage.

Districts were to continue to record the issuance and reduction of long-term debt in the general long-term debt account group (GLTDAG) through 2003-04. **Districts must continue to record the long-term liabilities in the general ledger and may designate a numeric or alpha fund number which is suitable for their software system, e.g., 100, 99 or LT. The ledger should be updated on a periodic basis (e.g., monthly), for internal control.**

Statement of Net Assets
General long-term liabilities include bonds, notes, and other long-term liabilities that are not directly related to and expected to be paid from proprietary and trust funds. Liabilities of the proprietary fund are reported in the proprietary fund *Statement of Net Assets*; liabilities of the trust fund are reported in the *Statement of Fiduciary Net Assets*. General long-term liabilities of the district should be reported in the governmental activities column of the district-wide *Statement of Net Assets*. Similar to the presentation of assets, liabilities are reported in the order of liquidity. "Liabilities with average maturities greater than one year should be reported in two components – the amount due within one year and the amount due in more than one year" (GASB 34, par. 31).

Interfund liabilities, even if non-current, are not long-term liabilities. District staff and auditors should refer to the revised GASB Codification 1500.

Governmental Funds Statements
Governmental funds reporting focuses on current financial resources, hence the fund financial statements do not include long-term liabilities such as bonds payable. The fund statements are intended to present a more detailed short-term view of basic education services with the most readily available assets and current liabilities. The governmental funds balance sheet includes a reconciliation of total governmental funds balance to the net assets of governmental activities. Long-term liabilities are a common reconciling item. The purpose of the reconciliation is to assist the reader to understand how the short-term financial information in the governmental funds statements differs from the more comprehensive financial information in the district-wide statements.

Disclosures
Refer to GASB 34, GASB 38, and the GASB Implementation Guides for guidance on disclosures including provisions for year-end accrual of interest, amortization of premium or discount over the life of the bonds and inclusion for discussion within the Management Discussion and Analysis.

Compensated Absences

Statement No. 16 of the Governmental Accounting Standards Board (GASB), "Accounting for Compensated Absences", changed the method for calculation of a district's liability for compensated absences (e.g., vacation, sick leave). This Statement supersedes the instructions shown on pages 13.4 and 13.5 of the GAAP Technical Systems manual regarding calculation of this liability for inclusion in the general long-term debt account group. By memo of May 15, 1995, this department advised School Administrators and Public School Accountants of the change. Auditors should refer to GASB 16 and the Codification of Governmental Accounting and Financial Reporting Standards, Section C60, for further explanation and illustrations of calculations of vacation leave and sick leave.

The inclusion of the long term portion of compensated absences in the district-wide Statement of Net Assets may generate a deficit in unrestricted net assets. This occurs because the pre-GASB 34 fund balance is based on current resources, whereas the GASB 34 net assets is based on economic resources and includes both long term assets and long term liabilities. When the long-term portion of compensated absences exceeds all other unrestricted net assets, a deficit will occur.

Early Retirement Incentive Program

Legislation enacted in 1991, 1993 and 2002 provided early retirement incentives (ERIP) for certain members of TPAF and PERS who met certain age and service requirements and who applied for retirement between certain dates in that fiscal year. The ERIP was subject to Board approval. School districts are assessed annually for their actuarially determined contribution to fund this program. Each participating district was given several options as to the length of time it desired to fund this liability. Under GAAP, the district liability is considered a contractual obligation. The liability is calculated for each participating district and billed to the district separately from its normal pension obligation, if any. In the *Statement of Net Assets*, the unpaid principal portion of the liability is included as part of the district's long-term liabilities. For fund statement purposes, advance payments made against that contractual obligation are considered GAAP expenditures in the year of payment. The department recommends proper footnote disclosure and a supplemental exhibit identifying the annual maturities.

P.L. 2002, c.42, effective July 12, 2002, revised *N.J.S.A.*18A:24-61.2 to permit NJ school districts to issue refunding bonds to fund their remaining ERIP liabilities. Auditors should refer to the Question and Answer Guidance on the web site http://www.nj.gov/njded/finance/fp/af/faq_retire.shtml. At the time the payment is made to retire the unfunded liability, the old balance is removed from the district's general long-term liabilities, the new balance recorded as a general long term liability and subsequently reported in the district-wide statement of net assets. The refunding transaction is reported in the S*tatement of Revenues, Expenditures, and Changes in Fund Balances* as "Other Financing Sources – Long-Term Debt Issued" and "Other Financing Uses – Repayment of ERIP Liability".

If there is not a requirement in the bond agreement to use the debt service fund, the transaction is recorded in the general fund. Districts and auditors should refer to GASB Codification sections 1500 and D20 for further guidance on year-end reporting and disclosures.

Arbitrage Requirements

The glossary of The Government Finance Officers Association's publication Governmental Accounting, Auditing, and Financial Reporting (the "blue book") describes rebatable arbitrage as "A term used in connection with the reinvestment of the proceeds of tax-exempt debt. A requirement to remit to the federal government interest revenue in excess of interest costs when the proceeds from the sale of tax-exempt securities are reinvested in a taxable money market instrument with a materially higher yield."

Districts should refer to page 66 of the GASB 34 edition of the "blue book" for guidance on rebatable arbitrage. "Rebatable arbitrage should *not* be treated as a reduction of investment revenues in governmental funds; it should instead be treated in the same way as any other claim or judgment. There should be no recognition in the governmental fund's balance sheet or operating statement until rebatable liability amounts are actually due and payable to the federal government."

Arbitrage Requirements (Cont.)

The AICPA Audit and Accounting Guide, Audits of State and Local Governments (GASB 34 Edition) includes guidance on arbitrage requirements in section 5.06. "Governments generally should calculate the arbitrage liability annually to determine whether it is material and thus should be reported in the financial statements." If material, the arbitrage liability is reported in the district wide statements and when actually due and payable, reported in the funds statements.